Supreme Court, U.S.
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No. 93-606

In The

Supreme Court of the United States

October Term, 1993

GREGORY C. KRUG,

Petitioner,

vs.

VALLEY FIDELITY BANK AND TRUST COMPANY and ELEANOR BARRON KRUG,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

RESPONDENTS' BRIEF IN OPPOSITION

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STATEMENT OF ISSUES

A. WHETHER CLAIMS BASED UPON WELL-SETTLED DOCTRINES OF STATE LAW WARRANT REVIEW BY THE SUPREME COURT OF THE UNITED STATES.

B. WHETHER THE SIXTH CIRCUIT PROPERLY APPLIED THE DOCTRINE OF *RES JUDICATA*.

RULE 29.1 STATEMENT

First Tennessee Bank National Association ("FTBNA") is the successor by merger to Valley Fidelity Bank and Trust Company. FTBNA is a wholly-owned subsidiary of First Tennessee National Corporation.

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STATEMENT OF THE CASE

A. SUMMARY OF PROCEDURAL HISTORY

The plaintiff, Gregory C. Krug, filed this action in the United States District Court for the Eastern District of Tennessee on August 27, 1991 (the "District Court Action"). In his initial Complaint, Mr. Krug sought specific performance of a real estate contract which he alleged he entered into with the defendants/respondents, his mother, Eleanor Krug ("Mrs. Krug"), and Valley Fidelity Bank and Trust Co. ("Valley Bank"), who were co-trustees of a trust established by Mr. Krug's father, George C. Krug (the "Trust"). The alleged real estate contract concerned property located in Blount County, Tennessee which was owned by the Trust (the "Property").

Mrs. Krug and Valley Bank moved to dismiss the Complaint. Subsequently, Mr. Krug filed a Motion to Amend Complaint, seeking to state claims for negligence by the co-trustees in their handling of trust assets. The district court dismissed the bulk of the Complaint and also denied the motion to amend based on *res judicata* (an action in state court between these same parties had preceded this case). After the filing of the Motion to Dismiss, the parties subsequently agreed to the sale of the Property to Mr. Krug and agreed that funds for disputed closing costs would be held in escrow pending the district court's decision.

The district court then ruled on the division of those costs, finding no contract for sale had existed between the parties prior to the filing of the Complaint. It assessed closing costs between the parties in the fashion customary in Knoxville, Tennessee.

Mr. Krug then appealed to the United States Court of Appeals for the Sixth Circuit. He contended that the district court erred in denying his Motion to Amend Complaint based on *res judicata*. In addition, he argued that he should not be required to pay closing costs since a valid contract was in force, which did not require him to make such a payment. The Sixth Circuit affirmed the district court's decision in all material respects.

Mr. Krug has now filed a Petition for a Writ of Certiorari with this Court, alleging that the doctrines of judicial estoppel and *res judicata* have been misapplied by the courts below.

B. STATEMENT OF THE RELEVANT FACTS

In his Petition, Mr. Krug recited facts that, in many cases, are either irrelevant or are not in the record. The salient facts appear below.

In 1990, litigation was filed in the Chancery Court for Knox County, Tennessee between Mr. Krug, Mrs. Krug, and Valley Bank (Case No. 105013-2) (the "Knox County Litigation") **(Affidavit of Paul Coleman and Exhibit B thereto; Record Document Nos. 5A and 10; Memorandum Opinion (of district court) filed January 27, 1992, p. 3; Record Document No. 16)**. The initial Complaint was filed by Mrs. Krug and Valley Bank, primarily to determine whether Mrs. Krug had the right to remove Mr. Krug as a co-trustee of the trust **(Judgment to Knox County Litigation; Exhibit B to Affidavit of Paul Coleman; Record Document Nos. 5A and 10, p. 1)**. Mr. Krug filed an answer and a counterclaim (the "Counterclaim") in response. **(Answer to Complaint and Counterclaim;**

Exhibit B to Affidavit of Paul Coleman; Record Document Nos. 5A and 10).

In the Counterclaim, Mr. Krug alleged a variety of improper conduct by his mother and Valley Bank, acting as co-trustees. He maintained that his mother had allowed the Property to be damaged. **(Counterclaim ¶ 9(B), p. 10, Exhibit B to Affidavit of Paul Coleman; Record Document Nos. 5A and 10).** In addition, in May, 1990, he alleged that his mother agreed to sell the Property to him for a fair valuation which Mr. Krug contended was $275,000. **(*Id.*, ¶ 9(I), p. 15).** Mr. Krug stated that his mother demanded $375,000 for the Property. **(*Id.*).**

Mr. Krug attempted to articulate several causes of action in the Counterclaim in the Knox County Litigation. In his third cause of action, Mr. Krug alleged that his mother "breached her fiduciary duties and caused damage to the Trust and [him] in an amount to be determined according to proof at trial, including but not limited to . . . a loss of Trust income attributable to the refusal to sell the . . . Property." **(Counterclaim, ¶ 19, p. 18, Exhibit B to Affidavit of Paul Coleman; Record Document Nos. 5A and 10).**

In addition, in his Counterclaim in the Knox County Litigation, Mr. Krug labelled two claims as his "fourth cause of action." In the first of these, he stated that "Eleanor breached her fiduciary duty in failing and refusing to sell the [P]roperty" and "[t]o remedy the foregoing, this Court should impose a constructive trust on the [P]roperty and cause it to be sold to Gregory at fair market value." **(Counterclaim, ¶¶ 23, 24, p. 19; Affidavit**

of Paul Coleman and Exhibit B thereto; Record Document Nos. 5A and 10). In Mr. Krug's second "fourth cause of action," he recited that his mother agreed to sell the Property to him at fair market value and that Mrs. Krug reneged on this agreement, demanding "$100,000 over the $275,000 appraised value of the [P]roperty." He then asked that the agreement be specifically enforced. **(Counterclaim, ¶ 26, pp. 19-20; Affidavit of Paul Coleman and Exhibit B thereto; Record Document Nos. 5A and 10).**

Subsequently in the Knox County Litigation, Mr. Krug filed an Amended Counterclaim in which he asserted, as his sixth cause of action, that Valley Bank "has failed and continues to fail to competently manage and make Trust assets productive." **(Amended Counterclaim ¶ 30, p. 31; Affidavit of Paul Coleman and Exhibit B; Record Document Nos. 5A and 10).** As part of this sixth cause of action, Mr. Krug asserted that Valley Bank had

> failed to exercise prudent business judgment in inventorying, managing and controlling the assets comprising the . . . Trusts. [Mr.] Krug is informed and believes and thereon alleges that Valley [Bank] has negligently failed to take account of a significant trust asset, [the Property], appraised at $275,000 and, in fact, does not even know if that real property is insured, is in default, its value, or whether or what repairs it needs.

(Amended Counterclaim ¶ 32, p. 5, Affidavit of Paul Coleman and Exhibit B thereto; Record Document Nos. 5A and 10).

Additionally in his Amended Counterclaim, Mr. Krug, in what he labelled his seventh cause of action, asked that he be given a judgment against Valley Bank for breach of fiduciary duty. (*Id.*, ¶ 36, p. 6; **Prayers for Relief, p. 7**). Finally, in his Amended Counterclaim, Mr. Krug charged as follows:

> Valley [Bank], additionally, failed to exercise prudent business judgment in inventorying, managing and controlling the assets comprising the [George Krug] Trusts. [Mr.] Krug is informed and believes and thereon alleges that Valley [Bank] has negligently failed to take any account of a significant Trust asset, the Family Residence [the Property], appraised at $275,000. . . .

(Amended Counterclaim ¶ 32, p. 6; Affidavit of Paul Coleman and Exhibit B thereto; Record Document Nos. 5A and 10).

The Knox County Litigation was tried on March 20 and 21, 1991. The Chancellor ruled against Mr. Krug on all of the above-referenced allegations. **(Judgment in Knox County Litigation; Affidavit of Paul Coleman and Exhibit B thereto; Record Document Nos. 5A and 10).** The judgment stated, in relevant part,

> 6. [Mr. Krug] failed to prove the allegations of the Second, Third and Fourth Causes of Action of his Counterclaim. Neither Mrs. Krug nor Valley [Bank] violated their fiduciary duties as Co-Trustees of the Krug Family Trust. Therefore, the Second, Third and Fourth Causes of Action of [Mr. Krug's] Counterclaim are dismissed with prejudice.

* * *

> 8. [T]he Sixth and Seventh Causes of Action of Mr. Krug's Counter-claim are dismissed with prejudice.

Approximately two months after the Knox County Chancery Court entered judgment against him, Mr. Krug wrote a letter to Valley Bank concerning purchase of the Property. Several letters were then sent between these parties addressing this topic over the following month. **(Complaint and Exhibits 1-4; Record Document No. 1).** The parties, subsequently, could not agree on closing costs and the sale of the Property was not completed. **(Affidavit of Paul Coleman and Exhibit A; Record Document Nos. 5A and 10).**

Mr. Krug then filed this case (the "District Court Action") in which he sought specific performance of a contract which he alleged resulted from this exchange of letters. **(Complaint; Prayers for Relief, ¶¶ 1-3, p. 4; Record Document No. 1).** In addition, he sought lost income and other expenses from the refusal of a prior $275,000 offer on the Property, which he alleged was made on May 14, 1990, almost ten months before the trial in the Knox County Litigation. **(Complaint, Prayers for Relief, ¶¶ 4, 5, p. 4; Record Document No. 1).**

Mrs. Krug and Valley Bank moved to dismiss the Complaint. **(Motion to Dismiss and for Sanctions; Record Document No. 5).** Initially, they alleged insufficient tender, then expanded the basis for the motion to include *res judicata* (based on the Knox County Litigation) and an allegation that no contract had formed between the parties. **(Motion to Dismiss and for Sanctions, Supplement to Defendant's Motion to Dismiss; Record Document Nos. 5 and 12).**

Subsequently, Mr. Krug filed a Motion to Amend Complaint and a proposed Amended Complaint. **(Motion to Amend Complaint and Amended Complaint; Record Document No. 13).** The Amended Complaint essentially restated the allegations of the original Complaint, but added some additional verbiage. The relevant portion of which appears below:

> 1. Prior to August of 1991, the Defendants maintained that the value of the Trust real estate was Three Hundred Seventy-Five Thousand Dollars ($375,000.00) to Four Hundred Sixty-Five Thousand Dollars ($465,000.00).
>
> 2. The Defendants, as Trustees, were negligent in dealing with trust property and should have known of the proper and realistic value of the property no later than May 4, 1990.
>
> 3. On May 4, 1990, Hop Bailey Company appraised the property at Two Hundred Seventy-Five Thousand Dollars ($275,000.00). Kenneth Woodford & Associates had previously appraised the property at Two Hundred Seventy-Five Thousand Dollars ($275,000.00) on approximately April 15, 1990.
>
> 4. The appraisals were made known to Valley's then attorney, William C. Wilson, who actually requested the Hop Bailey appraisal.
>
> 5. Had the Defendant sold the property at a non-negligent realistic price of Two Hundred Seventy-Five Thousand Dollars ($275,000.00) when the Plaintiff offered to purchase the property on May 14, 1990, the trust would have earned considerably more income. Valley Bank, through Robert Killefer, has previously stated under oath that the trust would have earned

more income had the property been sold and the proceeds placed in the Q-Tip trust.

6. [Mrs. Krug and Valley Bank] negligently withheld selling the property, insisting on a sales price of [$465,000].

* * *

10 Approximately five (5) months after the Chancery Court trial, the Defendants changed their position about the value of the residence by offering to sell it to the Plaintiff at Two Hundred Seventy-Five Thousand Dollars ($275,000.00).

11. Trustees are prohibited from selling trust assets for less than actual value and hence their offer to sell the residence for Two Hundred Seventy-Five Thousand Dollars ($275,000.00) is an admission that the residence is now only worth Two Hundred Seventy-Five Thousand Dollars ($275,000.00) and not Three Hundred Seventy-Five Thousand Dollars ($375,000.00) to Four Hundred Sixty-Five Thousand Dollars ($465,000.00) as the Defendants previously maintained.

12. [Mrs. Krug and Valley Bank] have either been negligent in allowing the trust property to depreciate in value by $100,000 to $190,000 or, they have been negligent in refusing to sell the property to [Mr. Krug] in May of 1990 by holding it out for sale at an unreasonable and inflated value.

(Amended Complaint; Record Document No. 13, pp. 1-4). Mr. Krug then stated he sought, "the loss occasioned by the trust [sic] due to Valley [Bank's] negligent handling of the trust residence." ***(Id.*, p. 4).**

The district court granted Mrs. Krug's and Valley Bank's motion to dismiss and denied Mr. Krug's motion to amend. **(Order; Record Document No. 17).** In its Memorandum Opinion, the court held that the District Court Action was "the same lawsuit" as the Knox County Litigation. **(Memorandum Opinion, p. 5; Record Document No. 16).** In addition, the court concluded that the so-called negligence claims were "no more than a thinly veiled description of [Mr. Krug's] claims for breach of fiduciary duties, which claims were fully litigated in state court." **(Id.)** Even if the negligence claims had not been raised in the Knox County Litigation, the Court reasoned they "reasonably could have been litigated" there. ***(Id.)***

Mr. Krug claimed that *res judicata* was inapplicable because he raised facts which occurred after the entry of judgment in the Knox County Litigation. The court rejected this contention and held that Mr. Krug "cannot attack a valid state court judgment in this court by raising facts which have their genesis at a point in time prior to the state court litigation and which specifically touch upon the same subject matter litigated in state court." ***(Id.,* p. 6).**

The parties subsequently agreed to the sale of the Property for $275,000 and to submit the issue of closing costs to the court on affidavits and proposed findings of fact and conclusions of law. **(Memorandum Opinion, p. 2; Record Document No. 24).** The court concluded that no contract existed (because the requirements of the "mirror image rule" were not met) and that closing costs would be allocated as they typically are between buyers and sellers in Knoxville, Tennessee ***(Id.,* pp. 5-6).**

Mr. Krug then filed an appeal to the United States Court of Appeals for the Sixth Circuit, which affirmed the district court in all respects. First, the Sixth Circuit analyzed the allegations concerning *res judicata*, finding that

> [Mr. Krug's] negligence allegations in the proposed amended complaint regarding Valley and Eleanor's mishandling of a trust asset . . . are essentially the same as the rejected "breach of fiduciary duty" allegations against Valley and Eleanor with respect to the Property in [Mr. Krug's] counterclaim in the Knox County lawsuit. (Opinion at 7).

Second, the court of appeals agreed with the district court's analysis that the requisites of the "mirror image rule" had not been satisfied, and that, therefore, no contract existed for sale of the Property. **(*Id.*, at 8).**

Mr. Krug now seeks review by this Court. He asserts that the district court and the court of appeals erred in application of the doctrines of judicial estoppel and *res judicata*.

SUMMARY OF ARGUMENT

The claims raised by Mr. Krug in this action are based on state law and are resolved by application of long-established doctrines. They are not of a magnitude sufficient to warrant review by this Court.

The courts below properly applied the doctrine of *res judicata* in finding that the judgment in the Knox County Litigation barred the District Court Action. Their rulings

did not preclude a future finding of negligence against the co-trustees should subsequent facts warrant it. In addition, the judgment in the Knox County Action indicated that dispute was fully adjudicated. Thus, *res judicata* barred the District Court Action.

ARGUMENT

A. CLAIMS BASED UPON WELL-SETTLED DOCTRINES OF STATE LAW DO NOT WARRANT REVIEW BY THE SUPREME COURT OF THE UNITED STATES.

Supreme Court Rule 10 states that "a petition for a writ of certiorari will be granted only when there are special and important reasons therefor." The text of the rule then lists situations which satisfy this standard, such as conflicts between decisions of various circuit courts of appeal or decisions by state or federal courts concerning significant issues of federal law.

This action falls far short of the standard stated in Rule 10. It is a prosaic case, resolved through application of the doctrine of *res judicata*, a fundamental, long-settled rule of state law. For that reason alone, the petition should be denied.

B. THE SIXTH CIRCUIT CORRECTLY APPLIED THE DOCTRINE OF *RES JUDICATA*.

The principles that apply to this case are fundamental. *Res judicata* applies when successive cases involve identical parties acting in identical capacities and when the subject matter of the second case "touches" the subject matter of the first. *Whitfield v. City of Knoxville*, 756 F.2d 455 (6th Cir. 1984). *See also Qualicare - Walsh, Inc. v. Ward*, 947 F.2d 823 (6th Cir. 1991) (reiterating this portion of *Whitfield* opinion). This general concept is amplified in *Isaac v. Schwartz*, 706 F.2d 15, 17 (1st Cir. 1983):

> Minor factual variations are beside the point. The question . . . is whether the second claim "grows out of the same transaction, act, or agreement and seeks redress for the same wrong," *Mackintosh v. Chambers*, 285 Mass. at 596, 190 N.E. 38, or whether "the second claim is an impermissible variation on the theme of the first." *Bradford v. Richards*, 11 Mass. App. 595, 417 N.E.2d 1234, 1237 (Mass. App. 1981).

See also Jaffree v. Wallace, 837 F.2d 1461, 1468 (11th Cir. 1988) ("*res judicata* extends . . . to all legal theories and claims arising out of the same 'operative nucleus of facts' [citation omitted].")

Mr. Krug's main argument for review by this Court is that the doctrine of *res judicata* was misapplied by the courts below in two ways. First, Mr. Krug asserts that the basis for this action is "depreciation of the Property which occurred subsequent to the Chancery Court trial." **(Petition at 6)**. He argues that this depreciation provides the basis for a new cause of action and that, under the district court's analysis, Valley Bank is "forever immune

from a charge of negligence". **(Petition at 8).** Second, he asserts that the Knox County Litigation was not ripe for adjudication and that, therefore, *res judicata* does not bar him from bringing the District Court Action. **(*Id.*, at 9-11).**

Mr. Krug's first argument is hopelessly flawed for one simple reason: the operative facts on which Mr. Krug relied in the District Court Action were before the court in the Knox County Litigation. Mr. Krug's proposed Amended Complaint in this case and the record in the Knox County Litigation amply support this position.

Three allegations are at the core of Mr. Krug's proposed Amended Complaint in the District Court Action: (i) a tentative valuation of the Property at over $400,000, (ii) subsequent appraisals which stated that the Property was worth $275,000, and (iii) a refusal to sell the Property for $275,000 in May, 1990. In the proposed Amended Complaint filed by Mr. Krug, he alleged that Valley Bank and Mrs. Krug had valued the Property at between $375,000-$465,000 (prior to the inception of the District Court Action). **(Amended Complaint, ¶ 1; Record Document No. 13).** In addition, he referenced the Spring, 1990 appraisals valuing the Property at $275,000. **(*Id.*, at ¶ 3).** He then alleged that the Trust would have earned more income if the Property had been sold in May, 1990. **(*Id.*, at ¶ 5).** (Significantly, Mr. Krug now maintains his only claim in the District Court Action was for depreciation of the Property, not loss of income. **(Petition at 6).**) He asserted that Mrs. Krug and Valley Bank were negligent in not selling the Property at that time. **(*Id.*, at ¶ 12).**

The record of the Knox County Litigation is replete with references to these facts. One need look no farther

than the testimony presented at trial. A real estate agent testified he listed the Property for $467,000. **(Exhibit D to Affidavit of Stephen E. Roth; Record Document No. 12).** Mr. Krug then testified about appraisals which valued the Property at $275,000 and his mother's desire to obtain $375,000 for the Property. **(Exhibit E to Affidavit of Stephen E. Roth; Record Document No. 12).** In addition, correspondence concerning these matters was introduced into evidence. **(Exhibits A, B and C to Affidavit of Stephen E. Roth; Record Document No. 12).** Furthermore, in paragraph 9(I) of his Counterclaim in the Knox County Litigation, Mr. Krug states his mother tried to "extort" $100,000 from him in May, 1990 because she offered to sell him the Property for $375,000 when it was only worth $275,000. **(*Id.*, ¶ 9(I), p. 15).**

This position is further supported by the causes of action Mr. Krug specifically stated in his Counterclaim and Amended Counterclaim in the Knox County Litigation. He sued both Valley Bank and his mother for breach of fiduciary duty and loss of Trust income. He asserted Valley Bank was refusing to make Trust assets productive, wasting Trust assets, and exposing Trust assets to risk of loss. These categories are certainly broad enough to include negligence which resulted in depreciation of the Property. Mr. Krug's allegation of depreciation in this action can, at best, be characterized as new evidence concerning the claims made in the Knox County Litigation.

There can be no dispute that Mr. Krug had the facts available to him in the Knox County Litigation sufficient to argue that the Property depreciated to $275,000 while his mother and Valley Bank were co-trustees. However,

he failed to do it. Thus, under the principles of *res judicata* he is barred from trying again.

Mr. Krug also asserts that the court in the Knox County Litigation concluded the dispute about the alleged negligence of Valley Bank and Mrs. Krug was not ripe for adjudication. However, the judgment entered by that court belies Mr. Krug's argument. It expressly states that each of the relevant causes of action (for breach of fiduciary duty) brought by Mr. Krug were dismissed with prejudice and that neither Valley Bank nor Mrs. Krug had violated their fiduciary duties.

Mr. Krug's judicial estoppel contention is likewise of no significance. The fate of his petition for review by this Court rises or falls on his *res judicata* argument. Through use of the doctrine of judicial estoppel, Mr. Krug attempts to use testimony allegedly given by Valley Bank in the Knox County Litigation (about the value of the Property) against it in the District Court Action. However, if *res judicata* barred the filing of the District Court Action, judicial estoppel obviously can have no application to that case or to review by this Court.

CONCLUSION

For the foregoing reasons, the Respondents, Valley Bank and Eleanor Krug, respectfully request that this Court deny Mr. Krug's Petition for a Writ of Certiorari.

Respectfully submitted,

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